

National Association of Public Pension Attorneys
Legal Education Conference
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Corporate Governance

- Security Exchange Commission is looking at alternative investments within governmental plans
- Concerns exist regarding fixed income options, REITS and return of capital to shareholders
- Treasury has created a new office to “look at” public retirement funding

Funding Policies: Navigating an ARC-less Sea

- Reminder - GASB is accounting based, not funding based
- Actuary’s steering committee established current guidelines for: model, acceptable, acceptable with conditions, not recommended and not acceptable practices (summary table of first 3 groups below)

Category	Actuarial Cost Method	Asset Smoothing Method	UAAL Amortization
Model Practices	Entry Age cost method <ul style="list-style-type: none"> • Level percent of pay • “Funding to retirement age” • For new tier, Normal Cost based on each member’s benefit • For future service changes within tier, Normal Cost based on current benefit structure (“replacement life” Entry Age) 	Smooth actuarial gain or loss on market value (MVA) Fixed smoothing periods, not less than 3 years Maximum MVA corridors: 5 years, 50%/150% corridor 7 years, 80%/140% corridor Combine smoothing layers only to avoid “tail volatility” Additional (solvency) analysis for closed plans	Layered fixed amortization periods by source of UAAL Level percent of pay amortization Amortization periods: Active plan amendments: Lesser of demographics or 15 years Inactive plan amendments: Lesser of demographics or 10 years Experience Gain/loss: 15 to 20 Assumption / method changes: 15 to 25 Early Retirement Incentives: 5 or less Surplus: 30 years Combine layers only to avoid “tail volatility” Additional (solvency) analysis for closed plans
Acceptable Practices	Aggregate cost method, with Entry Age based disclosures Frozen Initial Liability method, with Entry Age based disclosures Entry Age method with “Funding to Decrement” “Averaged” Entry Age normal cost for fut. svc benefit changes	Maximum MVA corridors: 10 years, 70%/130% corridor Five year (or shorter) smoothing with no corridor Rolling smoothing periods with MVA corridors equal to percentage recognition of deferred gains/losses, plus additional analysis	Up to 15 years for Inactive plan amendments Level dollar fixed period layered amortization with model amortization periods
Acceptable Practices, with Conditions	Projected Unit Credit method Aggregate Normal Cost variation of Entry Age cost method Aggregate or FIL without Entry Age based disclosures	Maximum MVA corridors: 15 years, 80%/120% corridor	Layered fixed amortization periods up to 25 years for all sources of UAAL Rolling amortization of a single combined gain/loss layer, with period that avoids negative amortization, with model periods for other sources of UAAL, separate layer for extraordinary gain/loss 30 year fixed amortization of method change or initial UAAL

Tax Update

- Form 1099-R reporting complicated by minimal associated code, no regulations, and inadequate instructions
- Some plans delegate reporting to custodians/record keepers, but maintain liability for correct reporting and significant risk of data errors/missing information necessary for delegated party to report correctly due to complex distribution schemes, ambiguous application of IRS codes, system upgrades etc.
 - Plans should NOT assume agents know how to ensure correct reporting and should periodically review agent’s process
- Reviewed numeric and alpha distribution codes and permitted combinations
- Reviewed IRS penalties for failure:
 - to withhold properly (payor liable for payment of taxes required to be withheld under IRC §3405(d));
 - to file timely and correct informational returns (penalties, Forms 941, IRC §6721);
 - to furnish timely and correct payee statements (penalties, Forms 1099-R, IRC §6722)

- Penalties for:
 - Forms 1099-R and 941 - \$100/return; \$1,500,000 per year maximum
 - Lower penalties for correction w/in 30 days (\$30/\$250k max) OR correction by Aug 1 (\$60/\$500k)
 - Higher penalties for knowing/willful failures
- Wisconsin experience:
 - Due to late filing in 2012 (~180k returns went to participants but NOT to IRS) following 2 new hires, internal retirements and 2x retirements of prior year and major law changes
 - IT staff discovered in August that many forms did not go to the IRS – IRS did not issue warning that there was an error with the report because nothing was submitted (but they do send file/email receipt)
 - Lesson: have compliance verify operations and IT actually file
 - IRS initially assessed penalty of \$800k, which had to come out of admin budget but would have put them over their cap; system appealed claiming mitigating factors and had some/all of penalty waived
 - Best case scenario: discovered internally soon after failure and quickly corrected (at least before penalty letter issued by Service) history of compliance, qualified status etc.
 - Waiver if failure for reasonable cause, major mitigating factors, events beyond filer's control etc.
- Notably, neither code nor regulations require correction of erroneously filed 1099-R but Instructions urge correction w/o apparent limit to time period and IRC § 6407(d) authorizes Treasury to prescribe reporting requirements "by forms and regulations"
- Normally correction period is presumed to be 3 calendar years back BUT if correction is of prior underreporting and additional amount exceeds 25% of member's income for year of original report, could be 6 years back (IRC §6501(e)(1))

Online Retirement

- OHIO: Following implementation of an on-line retirement application process, Ohio's average time to final a member's application fell from 64 to 24 days. Its call center experienced far fewer calls inquiring about the status of a member's application. The Ohio Uniform Electronic Transmission Act sets out the security standards needed and electronic signature requirements. The retirement system included disclaimers and acknowledgements on the web site, thus allowing e-signatures in most instances. Some documents still require a written signature. Lessons learned: test the system for high volume usage.
- MISSOURI: They instituted a two-step process. The application and necessary forms can be completed and submitted on=line. However, the retirement election form is still mailed out as a written signature is required for spousal consent. The on-line process is self-directed, similar to Turbo-Tax, with links to the application and forms. MO has an Electronic Signature Security Act which sets out rules for e-signatures.
- ILLINOIS MUNICIPAL: Similar to MT, Illinois Municipal entered the electronic stage slowly, starting with an employer "smart site", then adding a secure access site for active members and more recently implementing an interactive website. Initially members could only designate a beneficiary electronically; currently members can use the website to update their personal information; apply for retirement benefits, refunds, reinstatements, disabilities and retirement estimates; and register for educational seminars. Approximately 25% of refunds, 20% of retirement applications and 5% of disabilities are applied for on-line.

Q & A

- Notarized forms can't be done on-line. IL and MO now only require notarized signatures for refunds.
- Date of Marriage is required, but no marriage certificates
- All 3 systems made the changes "in-house" with IT working closing with Benefits

Alternative Investments

- Be very clear what alternative investments are permitted
- Watch for portfolio fees in addition to other fees
- Read disclosures correctly
- Beware of side letters as they generally contain carve outs or exceptions to fiduciary protections

Human Resources 101

- USERRA eligibility requires 5 re-employment criteria
 - qualified absence, gave notice, cumulative period less than 5 years, honorable release, AND;
 - timely return - limit extended up to 2 years for persons hospitalized/convalescing following a service-connected injury/illness

- Payment must commence at beginning of employment – duration of payment period limited to no more than 3 times the period of service, or 5 years, whichever is less
 - ERs who reemploy member shall notify plan in writing within 30 days after date of reemployment
- ADA covers disabilities AND perceived disabilities (facial scars, obesity, altered gait etc.)
 - Discrimination includes denial of reasonable accommodation
 - Most accommodations (69%) cost less than \$500
 - Don't assume similar disabilities can be accommodated similarly
 - Measure of undue hardship to provide accommodation based on size and resources of business
 - Unduly costly/disruptive, changes extensive/substantial or fundamentally altering operation
- FMLA at 29 CFR part 825
 - Federal provision for 12 weeks/480 hours of leave per calendar year
 - Usually State and Federal entitlements are counted concurrently
 - Military related leave allows eligible EEs to care for military member up to 26 weeks
- Sexual Harassment - prohibited under Civil Rights Act
 - Require EEs to sign policy, retain copy and conduct follow-up training
 - Get complaints in writing, request HR conduct investigation

Death & Disability

Colorado FPPA

- Duty eligibility annual based on substantial gainful activity includes review of whether member's earnings on a monthly basis average less than 20% of the average monthly salary paid to the Chief of a Fire/Police Department in the largest 7 departments within the state of CO
 - Calculation excludes reasonable costs to the member because of his/her impairment (SSA rules)
- Calculation like worker's comp (temp occupational, permanent occupational, total disability) excludes overtime and other payments
- Recent changes
 - Removed initial decision from Board to staff based on IMEs by 3 physicians – at least 2 must find disabling condition
 - Added 5 year limit to claw-back period for overpaid benefit
 - Classified fraudulently obtaining benefits as a felony

Colorado PERA

- Has long-term disability retirement like most plans; and
- Short term disability (must not be able to earn 75% of final salary elsewhere – subject of litigation)
 - 90 day deadline from last day of employment to apply – has not been challenged
 - 75% earning is based on statewide labor market survey – *would require relocation – issue not tested*
 - 60% of pre-disability earnings
 - Disability program administrator is an insurer, admins program, makes determination instead of Board
 - Advantages in taking Board out of process (sometimes conflict, overly sympathetic, w/o sufficient medical knowledge)
 - Disadvantage - administrator driven to make money, rather than acting in best interest of plan
 - Current contract allows PERA to control litigation and work with Admin's counsel...but if big \$ is involved contract allows Admin to settle out dependent of approval by PERA

New York Teachers

- Changed disability standard from inability to perform duties at time of injury to "all gainful employment"
- Challenges:
 - whether standard treatment plan could require treatment, including surgery
 - NY med board usually requires member to pursue if surgery deemed more than likely to cure
 - CO does not – just requires member to consider surgery and consult with physician
 - Drug/alcohol abuse
 - PTSD based on current environment – NY denies if PTSD would be alleviated in another school

Ethics

Perales

- NASA disaster following management vs. science based decision
- Failure/poor decision making likely under uncertainty, time pressure and shifted responsibility
- Ethics codes suffer when interpreted to suit the occasion

- “Unaware of the requirement”; “Focused on more pressing business”; “Don’t make a big deal”
- Methods to counter: pledge/signature, reminder

Salvie

- Duty to report issues
 - LOB problems initially downplayed to Board (same vendor and project manager as MPERA)

Nixon

- DOL Opinion Letter 2001-01A addresses: Settlor functions (see *p.10*) and fiduciary/Administrative functions
- Attorney-Client privilege defined by the client (staff, board, member) and nature/timing of request, funding of advice, role of requesting party, statutory limitations, defined role of counsel – See *Riggs, Nat’l Bank v. Zimmer*, 355 A2d 709 (Del. Ch. 1976), *US v. Jicarilla Apache Nation*, 131 S. Ct. 2313 (US 2011)
- Seven Step Determination
 - Whether actual or perceived conflict of interest b/n interested parties/potential clients
 - Determine whether compromised given the nature of the advice requested or requesting party
 - Clarify the source of payment for the advice – fund assets or sponsor
 - Define role if requesting party wears “two hats”
 - Identify issue as settlor function or fiduciary function
 - Clarify in writing whether advice is being provided to Fund, Board, Individual Trustee or Sponsor
 - Use outside counsel if actual or perceived conflict and clearly specify your client and outside counsel’s client

Litigating Against Plan

- City of Ft Worth amended benefits then sought declaratory judgment to determine constitutionality of change
- Order issued finding changes constitutional (for City) and awarding attorney fees to City despite plan having administered the changes made by the City!

DOMA and Taxation of Domestic Partnerships

- *Windsor* decision applies to ERISA-covered plans, not government plans
- Internal Revenue Service has issued *Windsor*-related rulings that do impact government plans
 - Same-Sex Spouses must be treated as any other spouse for the following purposes:
 1. Required Minimum Distributions (IRC 401(a)(9))
 2. Rollovers (IRC 402(c))
 3. QDROs/FLOs
 4. Hardships – beneficiary
 - Plans must determine effective date – decision effective June 26, 2013

Public Safety Disability Fraud

- 80 NY police and fire retirees caught up in disability scandal estimated to have cost \$400M
 - 134 indictments including applicant coaches, but as of yet, none of the doctors involved
- Some systems have instituted changes to:
 - Require medical board to make finding
 - Increase oversight of fraud risks, use fraud hotlines/other process for regular identification of risks
 - Reduce or eliminate incentives – may require statutory change
 - campaigns to educate about impact of fraud on systems/participants
 - authority to hire investigators to review claims as warning to departments more than effective tool
 - ensure appropriate professionals are involved in thorough and thoughtful claim review (medical specialists, investigators, forensic specialists)
 - create culture that promotes ethical behaviors, deters wrongdoing, encourages reporting
 - keep fraud awareness high by providing reports of situations/statistics to public/media
 - prepare board members to make decisions that may be unpopular among members/unions and address pressures from those groups in decision making
 - PTSD claims – implement 6th edition of the AMA Guides for psychiatric conditions; add malingering and exaggeration indexes to psyche evaluation
- Federal tax implications for disability fraud
 - Payment correction w/in same tax year is self-resolving
 - Repayment that occurs outside of single tax year depends on taxable (non-duty or duty-related) nature of benefits – may implicate criminal tax evasion provisions under IRC §7201

- Plan may need to issue corrected forms 1099-R for ALL included years (no 3 year limit b/c fraud prevents statute of limitation from running on tax assessment for years involved. IRC §6501(c)(1)(2)
 - See further reporting guidance in Foley/Bailey public safety slides p.32-36
- 2014 UBIT proposal from US Rep Dave Camp to subject organizations under IRC §401(a) to §115
 - Will probably not occur at least until January 2016 at earliest but would have serious ramifications, potentially generating about \$10B in 10 year period

DC Plan Group – Choice, Record Keepers and Hot Topics

- Mississippi, Colorado, Montana shared experiences w/ plan choice issues and procurement of record keepers
- The “plan choice rate” was paid off by the state in Colorado
- Neither MS nor CO have long-term disability in their DC plans
- MS pays Great West \$51/member
- MS keeps performance guarantees in a separate exhibit for ease of amendments

Bankruptcy

- Update from Detroit – complex agreement reached through mandatory mediation – removed COLA and roughly decreased benefits 4-5% along with other individual specific reductions with existing plan closure and plan replacement with hybrid plan
- San Bernardino, California – City stopped paying contributions to CALPERS and declared Bankruptcy. Rather than negotiate a deal, CALPERS sued. CALPERS and city recently reached an interim agreement which has been determined to be confidential. Other creditors are upset and may challenge.
- Stockton, California – City stated it had no intent to impair the retiree/pension relationship, then mediated an agreement with all unsecured creditors except the Bond Firm, including retirees. Trial ensued and was on-going during NAPPA. Pits retirees and members of CALPERS against the bond holders. Presiding Judge previously ruled that a Bankruptcy Court has the power to impact retiree health contracts.

Federal Legislation

- Secure Annuities for Employee (SAFE) Retirement Act – S. Hatch’s proposal to create annuity accumulation retirement plan allowing state and local governments to purchase fixed annuity contracts from insurance companies for each employee every year during their working career. Life insurance industry would pay the pensions and bear the investment risk.
- General pension reform proposals
 - Apply Unrelated Business Income Tax (UBIT) to public pensions – would tax income not substantially related to the performance of organization’s tax-exempt functions at highest corp. rate
 - Suspend inflation adjustments for the maximum DB benefit until 2024
 - Coordinate contribution limits for 403(b) and governmental 457(b) plans
 - Apply 10% early distribution tax to governmental 457 plans
- No resolution yet on definition of governmental plan – ANPRM still pending

Litigation Update

Summary of 28 recent significant decisions regarding constitutional, participation, service credit, salary and benefit computation, death/survivor benefits, refunds, employment after retirement, marital/dissolution issues, benefit forfeiture, freedom of information and open meetings.

- COLA amendment case in New Mexico held
 - “that in the absence of any contrary indication from our Legislature, any future cost-of-living adjustment [initially tied to the CPI then tied to system funding under the amendment] to a retirement benefit is merely a year-to-year expectation that, until paid, does not create a property right under the Constitution. Once paid, of course, the COLA by statute becomes part of the retirement benefit and a property right subject to those constitutional protections.”